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C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 003817

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TAGS: [ECON](#) [EIND](#) [ENRG](#) [PREL](#) [RS](#)
SUBJECT: RUSSIA: GAZPROM'S REACH INTO POWER SECTOR
THREATENS REFORM

REF: A. MOSCOW 01198
[1](#)B. MOSCOW 02728

Classified By: Acting Econ M/C Kathleen Doherty. Reasons 1.4 (b/d).

[1](#)1. (C) SUMMARY. In a July 27 board of directors meeting, electricity monopoly, RAO UES, approved the terms of an asset swap deal giving state-controlled gas monopoly, Gazprom, control over Wholesale Generating Company 2 (WGC-2) and WGC-6 in exchange for Gazprom's UES shares. Power sector reform seemed to be on track this spring with the transfer of UES's daughter companies to these strategic investors proceeding as planned. However, this latest deal giving Gazprom control over WGC-2 and WGC-6 and the proposed Gazprom/SUEK joint venture could potentially derail UES CEO Chubays' power sector reform by giving the sector's main fuel suppliers control over much of the country's power generation capacity.
END SUMMARY.

[1](#)2. (SBU) Gazprom, metals conglomerate Norilsk Nickel, and coal company SUEK are the three largest minority shareholders in RAO UES with 10.5 percent, 3.5 percent, and 1 percent, respectively. As part of UES's planned breakup, its minority shareholders are scheduled to receive proportional stakes in UES's constituent daughter companies, according to their

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current share holdings in the electricity monopoly, when the holding company ceases operations in July 2008. However, the UES board of directors on July 27 decided to allow Gazprom,

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SUEK, and Norilsk Nickel to swap out their diluted stakes in these daughter companies for controlling stakes in specific companies. In particular, Gazprom will receive 55 percent of WGC-2 and 52 percent in WGC-6 for its claim on UES daughter companies. SUEK will receive 13 percent in Territorial Generating Company 12 (TGC-12) and 15 percent in TGC-13 for its diluted stakes, raising its current share in the two TGCs to 56 and 47 percent, respectively. Norilsk Nickel will add to its current 73 percent stake in WGC-3 in exchange for its diluted shares.

REFORM SEEMED ON TRACK

[1](#)3. (SBU) As UES CEO Chubays has repeated many times over the past few years, the main objective of UES's planned breakup has been to introduce competition into the wholesale power

market by selling UES's newly created daughter companies, the five WGCs and 14 TGCs, to a number of strategic investors, who would then compete in power generation (reftel A). The transfer of UES's daughter companies to these strategic investors started to accelerate this spring with Norilsk Nickel acquiring a 38 percent in WGC-3 in a March private share offering. Subsequently, Norilsk bought out shares from minority shareholders and now holds 72 percent of WGC-3. In June, Italy's Enel purchased a blocking stake in WGC-5; the deal touted by Chubays as an example of the reform's progress. Afterwards, Enel announced plans to acquire a majority stake in WGC-5 (reftel B).

UES REFORM AT RISK

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14. (C) However, industry analysts are expressing concerns that this latest deal giving Gazprom control over WGC-2 and WGC-6 could potentially derail Chubays' power sector reform. As the power sector's primary fuel supplier and a major player on the wholesale electricity market, Gazprom could exert undue influence on wholesale electricity pricing. Gazprom already controls more than 50 percent of Russia's largest power company, TGC-3 or Mosenergo, Moscow's electricity provider. In addition to power plants in other regions, WGC-2 includes the Troitskaya and Surgutskaya GRES (State District Power Station), which power the oil and gas regions of West Siberia. WGC-6 includes the Kirishskaya GRES, which is UES's largest thermal power plant in the St. Petersburg region.

15. (C) In addition, the proposed Gazprom/SUEK joint venture would compound the problem of fuel supply companies entering the power generation sector by including a major coal producer. 59.1 percent of Russia's thermal power plants (i.e., excluding hydroelectric and nuclear) rely on gas, compared to 40.9 on coal. According to Vedomosti, a Federal Anti-Monopoly Service (FAS) analysis indicates that the deal

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would give the Gazprom/SUEK joint venture 45 percent of the thermal power generation capacity in the European and Urals region of Russia, and 42 percent of Siberia's power generation capacity.

COMMENT

16. (C) The latest news that the Gazprom/SUEK deal has been delayed until the end of the year may be a sign that back-room lobbying is intensifying. Anti-Monopoly Service head Artemyev has been a strong opponent of the proposed Gazprom/SUEK joint venture, but has also admitted that his agency could not stop the deal if the government wants it to proceed. The structuring of UES's wholesale power market and some FAS restrictions placed on Gazprom's activities in the power sector might be able to stave off some of the most anti-competitive advantages that Gazprom-controlled power plants would enjoy. However, a Gazprom/SUEK joint venture would almost certainly end any hope of salvaging Chubays' power sector reform. END COMMENT.

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